DOW THEORY LETTERS INC.

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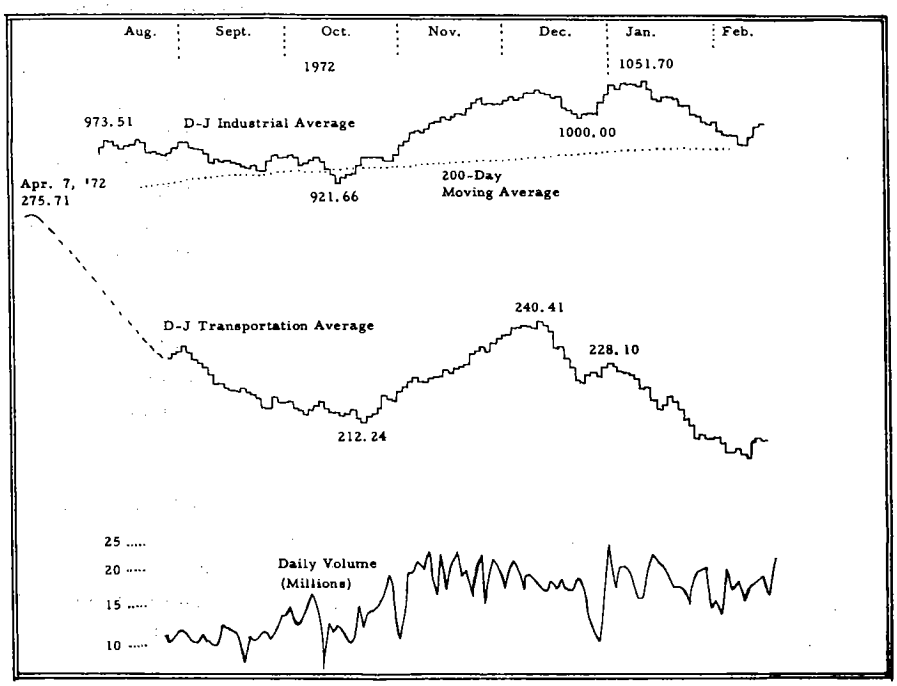
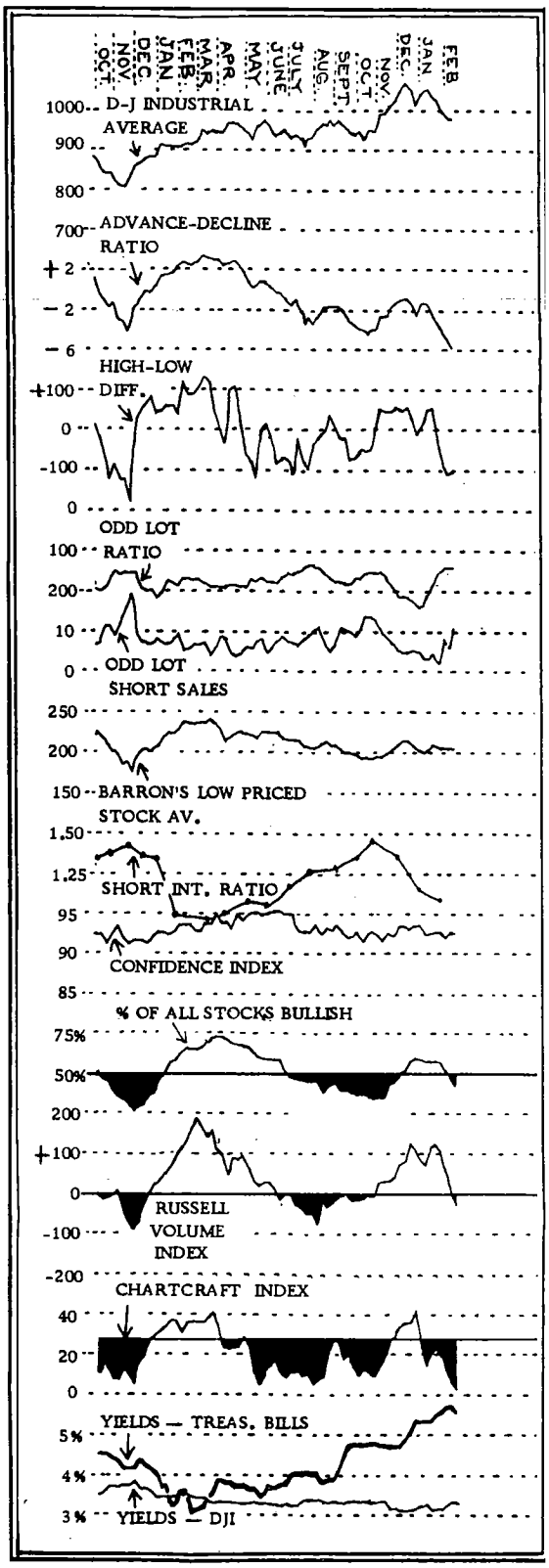
Feb. 1, DJIA 980.81, PTI 969, A-D ratio -4.96
Feb. 8, DJIA 979.46, PTI 944, A-D ratio -5.91

THE PICTURE: Down, down, down to defeat goes the currency that only twenty years ago was considered the greatest in the world. To the everlasting shame of bungling Presidents, mealy-mouthed politicians, spineless Secretaries of the Treasury, weak and ignorant Federal Reserve Board members, the once-mighty dollar on February 12 slipped another major notch towards the grey oblivion of history.

As the fabled Greek "drachma" has gone, as the proud Roman "aureus" has gone, as the Byzantine "byzats" has gone, as the powerful French "tournois," the German "groshen," the Spanish "dinar," the first German "mark," the wondrous US "double eagle" and a hundred other once-prized currencies have gone, so too the dollar is rushing, headlong, relentlessly into the monetary museums and artifact collections of tomorrow.

Only 14 months ago the US dollar was devalued by 8.5% in the Smithsonian Agreement which President Nixon termed "the most significant monetary agreement in the history of the world." The "significance" of this earth-shattering arrangement lasted a little more than a year, and on February 12 the dollar was devalued another 10%, and the price at which the US "would not sell golds" was raised to $42.22. Since gold is already selling on the free market at almost $30 over the new fantasy "official" price, it can be seen that the second devaluation is merely an attempt to help the dollar's trade position. It has nothing to do with the true value of the dollar in terms of gold, which has already been (by world markets) judged to be far, far lower than the "official" $42.22 price.





And what of the repercussions; is everything all right in the US monetary dream factory? For one thing, the new devaluation presents the most serious consequences in terms of the energy crisis and the looming oil shortage. Already, Iran has announced that she will lose around $400 million via the new lower-value dollar, and she wants to renegotiate her oil contracts. Other oil nations, already glutted with dollars, will follow. It has been estimated that by 1980 the US will be running a trade-balance deficit of $20 billion based on oil imports. With all imports now more expensive, the deficits will run even higher, assuming no revolt of the oil sellers regarding their build-up of more mountains of fiat dollars.

A devaluation only means something when instituted along with other drastic, constructive, painful steps, steps directed towards protecting the devalued currency. All too often a devaluation simply measures a currency's descent into worthlessness. So far, I fail to see where any fundamental, tough, anti-inflation steps have been taken to back the new, devalued dollar, and I must admit that I don't even see the US thinking in terms of a real program to turn the nation into a competitive bastion of economic strength.

This devaluation, like the one before it, is calculated to be a "holding action," a stop-gap which will suffice for another six months or a year — until some miracle from outside can "make everything OK." Meanwhile, the other nations of the world will continue building their competitive strength; they will continue to move towards their own currency; they will continue to collect gold with which to back a new currency they can trust.

There is also the matter of convertibility. For behind all the hopes for a solution, the fact is that ultimately the dollar must be convertible or it will lose reserve status in favor of a stronger currency which can stand the test of value — convertibility into gold. It was notable that unlike the events of the last dollar devaluation, this time gold shares did not sell off on the news — nor did the gold bullion price collapse. The reason: It is becoming very clear that if the dollar is to become convertible, it will have to be so with gold at a much, much higher price. If the dollar is to be replaced as the reserve currency, gold will still be raised in price in relation to the new currency and it will still require many more dollars to purchase an ounce of gold.

As I have written before (Letter 552), the US with the imposition of Phase III declared to the world that it would do nothing about inflation. It was therefore more than coincidence that the world panic out of dollars came only weeks after the President's Phase III announcement and that devaluation came within a matter of days after the dollar panic began.

There may be those who feel that I am being too hard on Uncle Sam and that "If I don't like the way our leaders are running the country, I should move to Switzerland or the Canary Islands or some other earthly paradise." But my family has been here since before the American Revolution, and I have no intention of doing anything but staying right here in Southern California and saying what I feel is the truth. The truth is that this nation has just fought a largely useless war that it could not afford, it is spending money it cannot afford, it is following an inflationary policy it cannot afford, it is running budget deficits it cannot afford, it is living in a dream world that it cannot afford. And the markets of the world prove it, for the dollar is now selling in international trading at the lowest price in its history. And the trend, from all my observations, continues to be down.

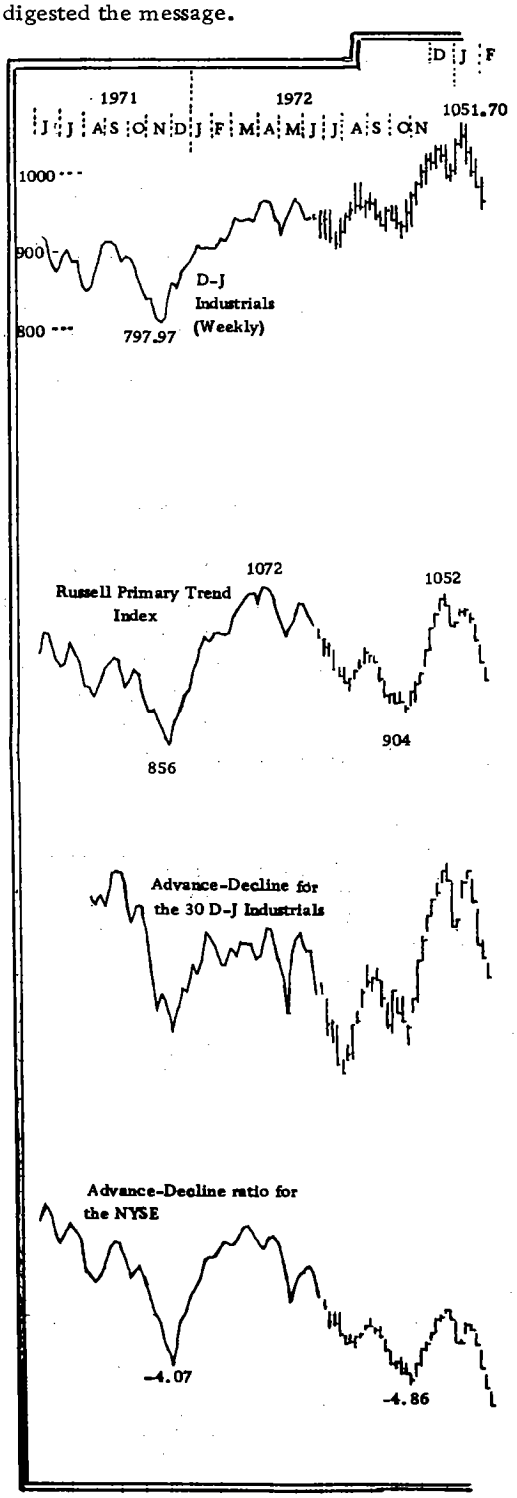
From all I have written here, it should be clear that the tides of history force themselves irresistably upon man and his markets. For instance, during 1972 the mutual fund industry suffered its first loss of assets on a yearly basis. Redemptions overpowered purchases by $1.67 billion in 1972, and the funds lost whatever aura they had left. On February 7 a sort of obituary for the funds appeared in the Wall Street Journal via a full page advertisement. The ad was by Dreyfus A.M., which headlined that it was "A Dreyfus that isn't a fund." What was this exotic new vehicle which took up a full page in the Journal to tell the public about? It was simply individual portfolio management. Why was it worth a full page? Because it offered the public an illustrious Wall Street name to handle their money on an individual basis — rather than on a fund basis. Conclusion: If you can't sell management on a fund basis, sell it on an individual basis. Long live the advertising business.

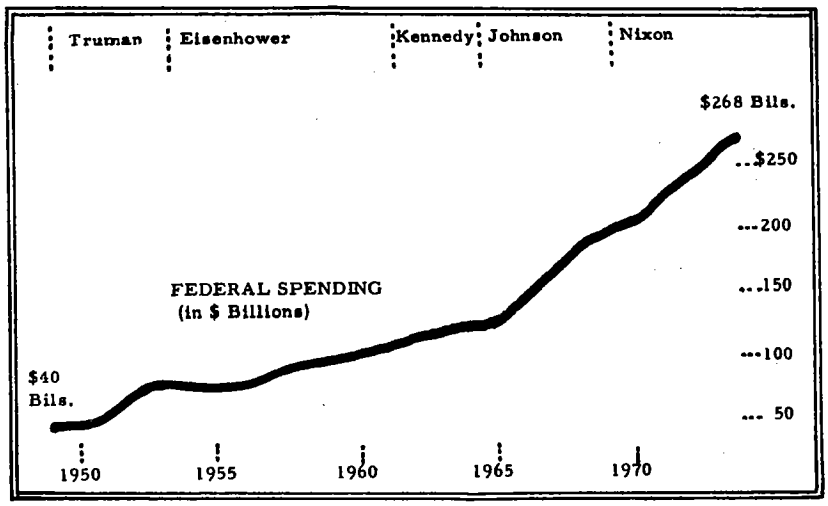
There's still another trend taking place, and it can be seen in the profile of the advance-decline line. It's the trend of a listing ship, and in this case the ship is the great mass of issues on the NYSE. The ship is slowly sinking, first below its 1973 low, then below its 1971-72 low, and now it is within "shooting distance" of its 1970 low, the low that marked the bottom of the worst market collapse since 1937.

The A-D line can be likened (as can the Value Line Average, see last Letter) to the equity of the US. The A-D line traces the advancing or declining tendencies of the majority of stocks on the NYSE. This line has been pointing down ever since the powerful 1970-71 advance. No wonder the public is disillusioned with Wall Street, no wonder they are turning in their mutual funds and selling their odd lots. If the primary trend was bullish, if the majority of stocks were rising, if the public was making money on their common stock holdings, we could be sure they would now be buying more shares, not selling them.

Another curious thing is happening. The public is discovering that they would prefer to hold the debt of US corporations than their equity. For as the mountain of debt grows (see Federal Budget chart page 3) the cost of servicing that debt has sky-rocketed—

until interest rates are now roughly the highest in 100 years. And Wall Street has found a way to sell the debt of America and its companies to the public. Enter the bond fund. The bond funds have burst upon the Wall Street scene like Santa Claus at a poverty-protest rally. Suddenly, everyone has discovered that bonds at 6% to 8% are a great bargain, and that they can be bought in a package via the bond funds. Who needs equities yielding an average of 3% when you can buy a bond fund yielding 7%? The public has digested the message.





To get to Wall Street itself, in the last Letter I documented on a single chart some of the disparate forces which were reflecting trouble in the US markets and the markets of the world. Note on the page 1 chart that the percentage of all NYSE stocks in bullish trends has now dropped below the critical 50% level. Note the collapse in the Chartcraft Index and the Russell Volume Index. Near the top of the chart it is clear that the daily high-low differential on the NYSE never "checked out" on the upside during late 1972 or early 1973, and that index is now heavily into negative territory.

At the bottom of page 1 we have the daily chart of the D-J Averages. Here we see what I have been writing about for months, the extraordinary divergence in the two Averages. I don't want to go over the whole flagrant series of non-confirmations and divergences again, but it is now evident that we have a technical change in the situation.

With the Transports breaking their 212.24 low of October 20, it becomes a question of whether Industrials will confirm on the downside. The October 16 low for Industrials was 921.66, and this is the level we will watch for regarding the long-term strength or weakness of the market.

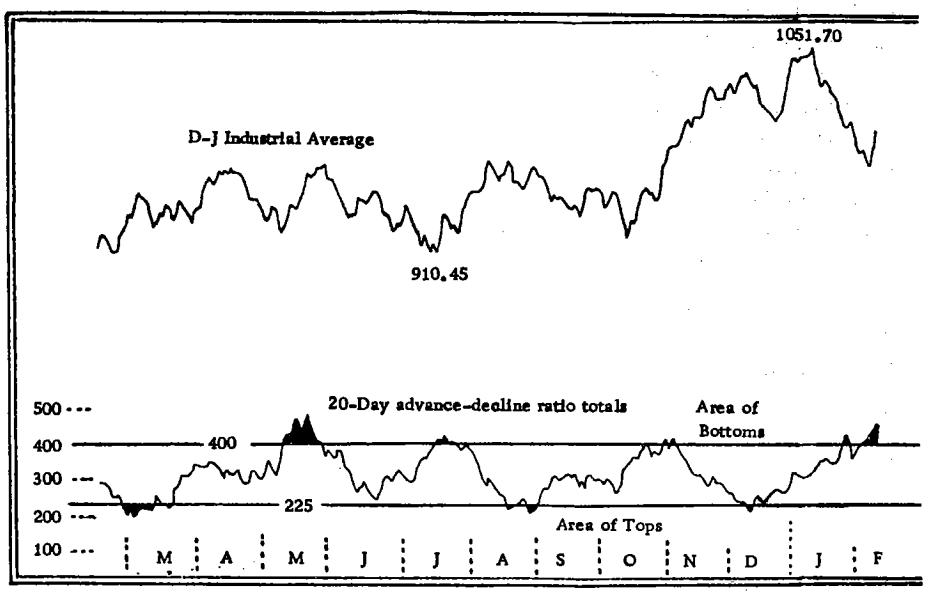
From the longer-term view, I have included the chart of three key indicators of market action, with the weekly Dow Industrials movements plotted at the top for comparison purposes.

The Primary Trend Index (PTI) is an amalgum of 8 critical market indicators, and this index provides a running measurement of comparative market strength or weakness. At the recent December peak of 1052, the PTI failed to better its 1972 high, thereby giving the lie to the new record high in the Dow. In January the Dow pushed to its all-time high of 1051.70, and here the PTI failed even to better its December peak. This proved too much for the market, and the general decline was underway. Note, however, that the PTI has held above its October low of 904. This now looms as a crucial downside figure for the PTI.

The A-D index for the 30 Dow Industrials measures the breadth in the DJI alone. The October to December strength in this index took it exactly to the September, 1971, peak, a good performance. The Dow A-D failed to confirm in January (it would not better its December high), and it fell badly during January and February. We'll see how it does on the rally.

Finally, the A-D ratio for the entire NYSE is a sad affair, as the graph plainly shows. At its recent low of -5.91, it missed smashing the 1970 low by a hair (the 1970 low was -6.08). On the recent low day (Feb. 9) the Big Board produced 173 new lows for the year, which means that better than 10% of all NYSE common stocks hit lows that day. This is what happens when the A-D ratio collapses.

In Letter 550 I presented an "overbought/oversold" indicator which I have found to be outstandingly useful. This indicator is the total of the daily advance-decline figures arranged in a 20-day moving average. The daily figures are added, regardless of whether they were plus or minus.

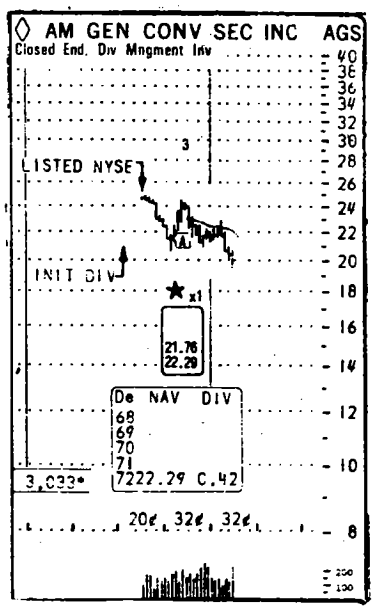


As a market advance nears its ultimate peak, "churning" will occur. This means small daily A-D figures. When the 20-day total of these figures drops below 225 (see chart), the market can be considered in a "top" area as shown by the solid black areas in the area marked "Tops" on the chart. Conversely, during a sell-off the daily declines will tend to mount to climatic proportions (with daily advanced shrinking drastically). This will produce large daily A-D figures. When the 20-day total rises above 400 we enter the "Bottom" area on the chart.

On January 29 this index jumped over 400, fell back below the 400 level for a few days, and then on February 8 the index again pushed above 400. The index is in the solid black area (above 400) as of this writing, which indicates an oversold condition.

How strong will the ultimate rally be from the "oversold" area? From its January 11 closing high of 1051.70, the Dow Industrials plunged 84 points to the February 8 low of 967.10. With a few days of frenzied action climaxed by the devaluation news, the Dow has made up more than half its losses and in so doing has left all other confirmatory indices far behind. Veteran readers may remember the market adage which I often quote, "The first reaction of the market to unexpected news is often opposite the trend which the market will shortly follow." The initial reaction to the dollar devaluation was a 22 point morning rise in the Dow, cut to a closing 5 point gain with fractional losses in the Transports and Utilities. On February 14 the market opened sharply lower, a far cry from the enthusiams the Government was trying to whip up for the "Son of Smithsonian."

MORE ON BOND FUNDS: The bond fund concept is about the hottest thing on Wall Street these days, and with some justification. The fact is that many bond funds offer the average investor a high-yield place to put his money, all with a good degree of safety. There are two bond funds which are not well known which I want to draw attention to in this report. The first is the "Fund for US Government Securities, Inc." This is an open-ended fund with an "objective of current income by investing only in securities which are obligations of the US Government or its instrumentalities." Dividends on this fund are paid quarterly, and the cost of the fund is a mere 1.5% on quantities of less than $10 thousand, 1% on $10 to $20 thousand, and on a sliding scale down to .1% on $500 thousand or more. The Fund is listed in the Wall Street Journal under US Gvt S and the Fund sells for about $10.54 (asking price). At last year's dividend payout of 72¢, this would provide a 6.8% yield. All of which is rather attractive. This Fund is quite new, having been formed in late-1971. (Dow Theory Letters has purchased a small amount of this fund).



A second fund worth drawing attention to is American General Convertible Securities. Unlike the previous fund, which is open-ended (that means that all purchases and sales are made by the fund itself and exact asset value is always quoted), the Convertible Fund is closed-end. This means that the fund is sold on a supply-demand, bid and asked basis as with any other stock. The Fund is listed on the NYSE (AGS). It was formed in 1972 and sold as high as 25 1/8. Last week AGS broke as low as 19½, a new low since its inception. Dividends are paid monthly at the rate of 11¢ per month or $1.32 a year, and capital gains are also a possibility or at least a hope.

AGS's aim is current income and capital gains potential, and the fund hopes normally to invest at least 80% of its assets in (1) convertible securities, (2) dept securities with warrants attached, (3) securities of, or guaranteed by the Government, (4) top commercial paper, (5) cash or equivalent. This fund is managed by a subsidiary of American General Insurance Co., the same outfit that manages American General Bond Fund. I think the management knows what it is doing, and I find this fund an interesting one.

Why do I find it interesting? Because at the current dividend, the stock (or should I call it a stock/fund) at a price of 19 3/4 yields an attractive 6.7%. Furthermore, the fund is selling under assets which are now about $21.76 (according to the Quote chart, although with the market drop the net assets are probably lower at this time).

I would suggest that subscribers watch this listed fund, and we should remember that the lower this fund goes, the more attractive the yield. And always, there is a potential play on the upside because of the convertible feature of the type of instruments this fund deals in.

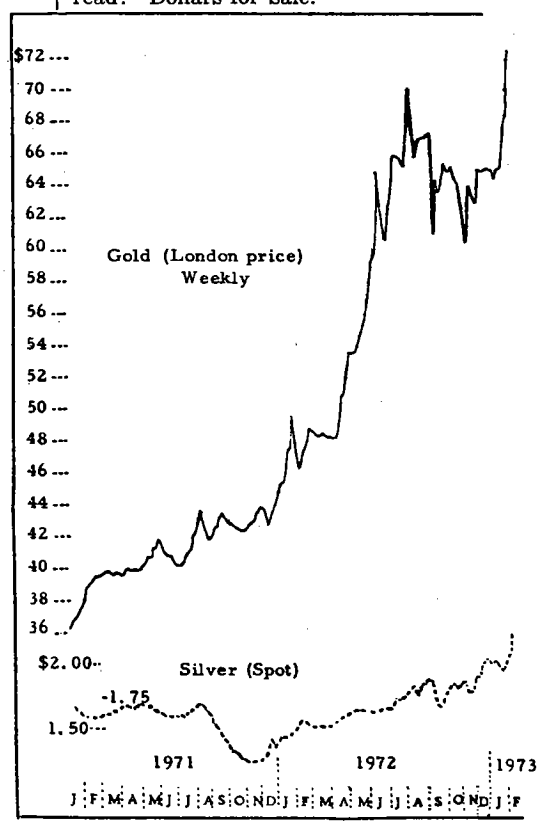
It should be remembered, however, that if the convertible instruments in this fund's portfolio drop way below conversion price, then regardless of attractive yield the fund could be sluggish during a market rally, since theoretically a big rally in the market could only move their convertible vehicles from "way below conversion" to "somewhat below conversion." In that case, one would be sitting with a high-yielding but sluggish fund, which is not exactly a catastrophe. The other point to remember is that this Fund can sell at a premium if investors get optimistic (which they are not now) or a discount (if they get pessimistic, which they are getting). This process gives investors bargains in gloomy markets and extra profits in frothy markets. Which means leverage both ways, if you're smart in your timing.

GOLD & SILVER: On February 14 the London gold price rose $3.40 to a record high of $72.30. This was the free market's answer to the new "solution" for the dollar. And despite the Administration's mouthings that confidence had been restored, the Wall Street Journal (Feb. 14) published an article on its editorial page which indicated that the dollar was rapidly becoming the laughing stock of the world (see news clip). How the mighty have fallen. Perhaps coincidentally, the Journal the day before carried news of Homestake Mining's 1972 earnings. They were up from $2.6 million in '71 to $7.2 million in '72, a rise of 177%.

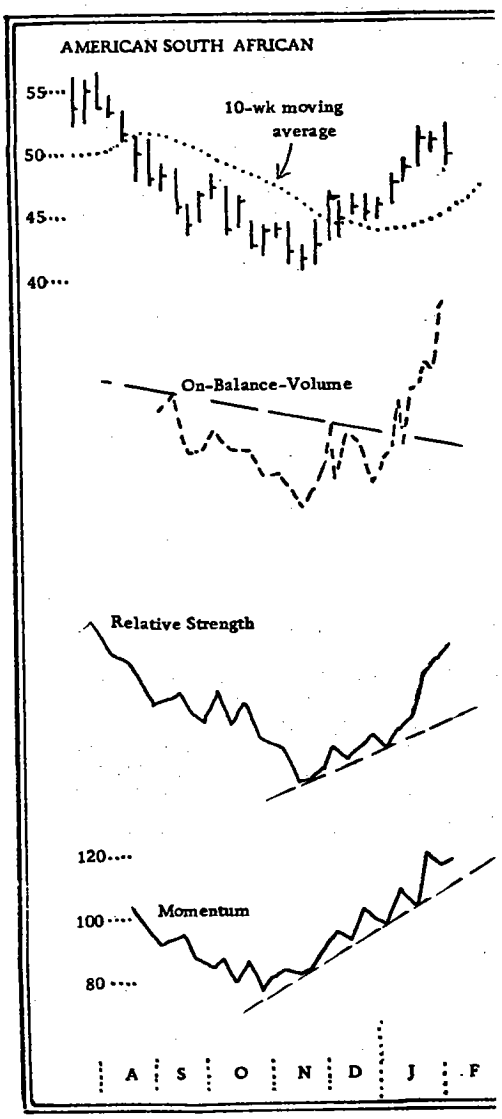
STOCKS: As of this writing, four Dow Industrial stocks hold high ratings of 4, 5 and 6 while 17 Dow stocks hold low ratings of zero or 1. The strong stocks are Allied Chemical, Anaconda, Exxon and Standard of Calif. The two oils are losing strength, however. The zero or weakest rated stocks are Bethlehem Steel, Goodyear, Int. Harvester, Owens Illinois, US Steel, Westinghouse, Woolworth.

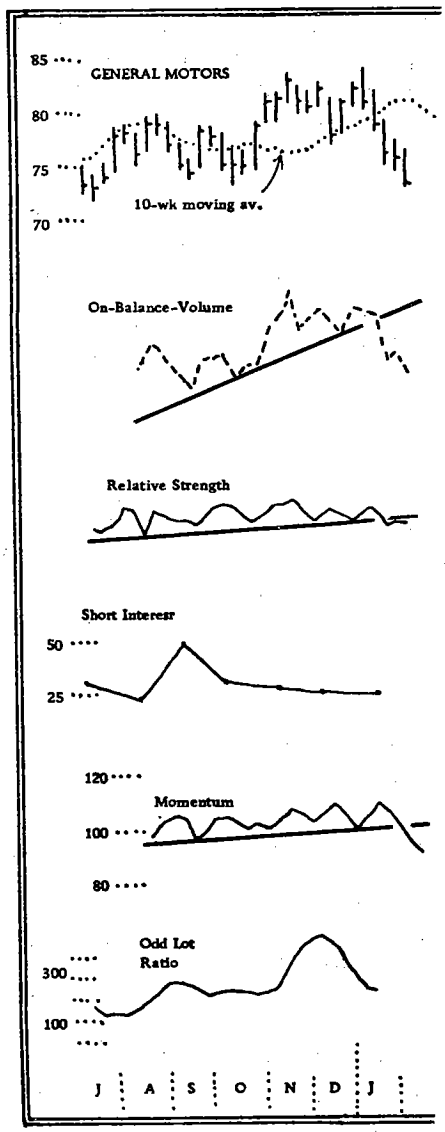
I have included a chart of Allied Chemical...The chemical group has just turned up sharply on a relative strength basis, after a long sideways movement since early 1970. Everything on my special technical chart checks out on ACD, although I would prefer that odd-lot selling were a good deal stronger (in other words, that the ratio was up nearer 1000). However, for those intrepid traders who insist on jumping in on the next rally, I would consider Anaconda and Allied an interesting package. Anaconda, recommended in many recent reports as a good trading vehicle, hit a new high for the year on February 13.

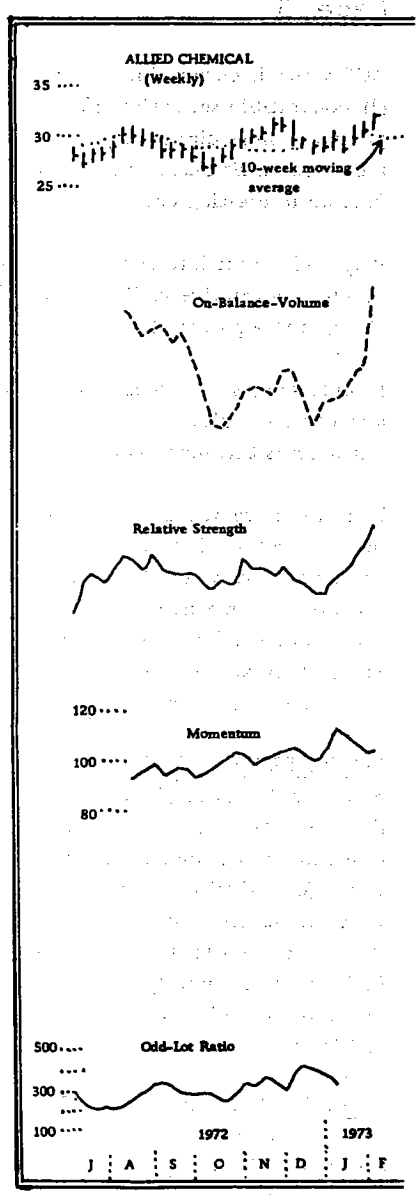
European newspapers, too, are having a merry time ridiculing the U.S. and its anemic dollar. The Sunday Times, a London weekly, had a cartoon of an American flag hanging at half-mast, dollar signs replacing the stars on the flag. The Observer, also of London, had one of the Statue of Liberty holding a handful of dollars instead of a torch. The caption read: "Dollars for Sale."



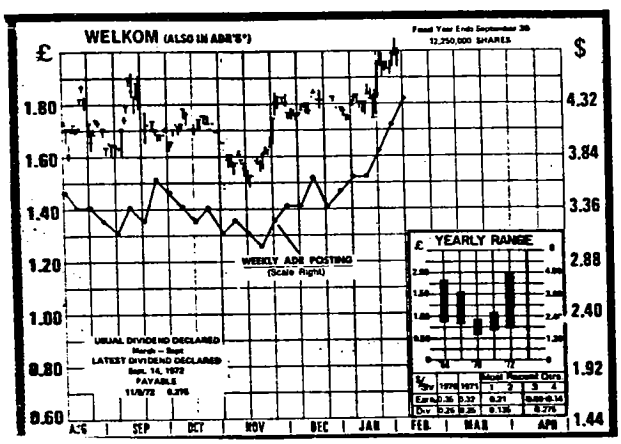
I noted in Letter 553 that bellwether General Motors had dropped to a 1 on my technical ratings, and that it was not acting well at all. GM has continued to act "doggy" ever since, and when this happens, there is something amiss in the market. Whatever is big enough to affect GM adversely will usually affect the whole country adversely. And that seems to be what is happening, as can be seen on the chart (page 6).

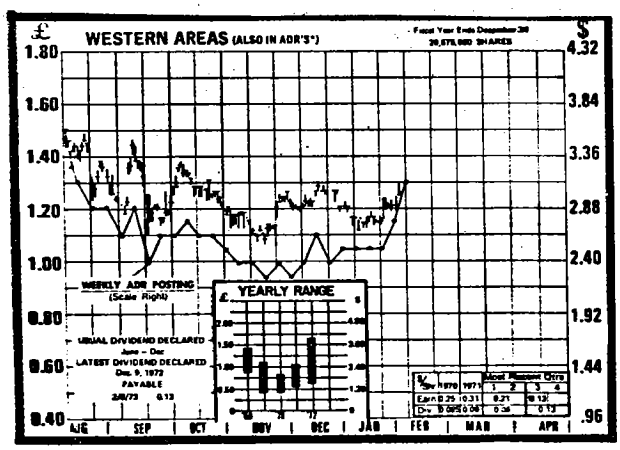






I include my weekly chart of American South African, the gold-holding investment trust. Note the tremendous build-up or accumulation on the OBV line. Relative strength is in a firm uptrend as is momentum. ASA is holding above its now-rising 10-week moving average, and the latter is at roughly 48. Hold ASA for the unfolding of the dollar-gold story. It's a story that's far from over.





Above are two low-priced S. African golds which I think are attractive, both available in ADR's (courtesy of Indicator Chart Service, Palisades Pk, NJ 07650).